



# CITY OF SANTA BARBARA

## FINANCE COMMITTEE AGENDA REPORT

**AGENDA DATE:** November 20, 2007

**TO:** Finance Committee

**FROM:** Administration Division, Finance Department

**SUBJECT:** Professional Actuarial Services Agreement For GASB 45 –  
Accounting For Retiree Medical Benefits

**RECOMMENDATION:** That the Finance Committee recommend that Council authorize the Finance Director to negotiate and execute a professional services agreement with Aon Consulting for an actuarial valuation of the City's post-retirement benefits, including retiree medical insurance and sick leave conversion programs, for \$30,000.

### DISCUSSION:

In June, 2004, the Governmental Accounting Standards Board (GASB) issued Statement 45, which establishes standards for the accounting and financial reporting of "Other Post-Employment Benefits" (OPEB). "Other Post-Employment Benefits" refers to retiree benefits other than pensions and includes retiree medical and any other benefits provided to employees upon or in retirement. Essentially, GASB Statement 45 requires governments to account for and report OPEB just like they currently account for and report their pension liabilities. It is important to understand that GASB 45 only establishes accounting and financial reporting standards for OPEB and does not establish any funding standards or requirements. The purpose of GASB 45 is to establish a standard, more accurate way to measure the true cost of OPEB and provide more transparency in reporting those costs. Under the timeline established by GASB, Statement 45 takes effect this fiscal year. The City must be prepared to report our OPEB liabilities in our audited financial statements for the fiscal year ending June 30, 2008.

The City currently has two OPEB programs that will require actuarial valuation. The first is retiree medical. Pursuant to the City's various labor agreements, the City makes fixed monthly contributions to certain retirees' medical insurance premiums. The monthly payments are a fixed dollar amount for each year of service from the time of retirement until the retiree reaches age 65. The amount of the payment varies by bargaining unit. For example, under the labor agreement with the SEIU, the City's "general employees" (non-safety) are eligible for a City retiree medical contribution if they retire from City

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REVIEWED BY: \_\_\_\_\_ Finance \_\_\_\_\_ Attorney

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service with 15 years or more of City service. If an employee meets that criterion they are entitled to receive a City contribution towards their medical insurance coverage of \$8.75 per month, per year of service, up to a maximum of 35 years of service (\$306.25). That benefit is payable from the date of retirement until the retiree reaches age 65 at which time they become Medicare-eligible.

The other OPEB is a sick leave conversion benefit. Again using the SEIU labor agreement for the City's "general employees" as an example, eligible employees retiring from the City with at least 500 hours of accumulated sick leave are entitled to receive an lifetime annuity equivalent to the additional amount they would receive in their CalPERS retirement if their accumulated sick leave hours were converted to service credit for the purposes of calculating their CalPERS retirement benefit.

In order to determine our OPEB liability the City must retain the services of a certified actuarial firm. The actuarial firm will use standard actuarial practices to determine the City's OPEB liabilities and future cost projections in accordance with GASB 45 requirements. The City has received a proposal from Aon Consulting (Aon) to conduct the City's GASB 45 actuarial valuation. Aon is an actuarial, benefits and insurance consulting firm with extensive experience in public agency actuarial valuations. Aon has recently performed GASB 45 valuations for over 40 California public sector clients. A copy of Aon's proposal is attached. Aon has performed previous actuarial valuations for the City and the quality of their work has always been outstanding. Aon has proposed to do the actuarial valuation for the City's OPEB for \$30,000.

The City is required to obtain the actuarial valuation in order to comply with the requirements of GASB Statement 45. Staff recommends that we accept Aon's proposal and proceed with the required valuation.

#### **BUDGET/FINANCIAL INFORMATION:**

The cost of the actuarial valuation was not included in the fiscal year 2008 budget. Because the actuarial valuation is a city-wide study and includes all of the City's Enterprise Funds as well as the General Fund, Staff recommends that the cost be spread across all funds based on the salary and benefit budget of the various funds. This will result in a General Fund cost of \$19,500 (65%) because the General Fund represents 65% of the citywide salary and benefit budget. Staff recommends that the General Fund's share be funded by a \$19,500 allocation from the General Fund's Appropriated Reserve. The portion of the cost allocated to any of the Enterprise Funds will be so nominal that the funds will be able to absorb the cost within existing appropriations.

**ATTACHMENT:** GASB Statement 45 on OPEB Accounting by Governments – A Few Basic Questions and Answers

**SUBMITTED BY:** Robert D. Peirson, Finance Director

**APPROVED BY:** City Administrator's Office

## **GASB STATEMENT 45 ON OPEB ACCOUNTING BY GOVERNMENTS A FEW BASIC QUESTIONS AND ANSWERS**

### **1. Why was Statement 45 on OPEB accounting by governments necessary?**

Statement 45 was issued to provide more complete, reliable, and decision-useful financial reporting regarding the costs and financial obligations that governments incur when they provide postemployment benefits other than pensions (OPEB) as part of the compensation for services rendered by their employees. *Postemployment healthcare benefits*, the most common form of OPEB, are a very significant financial commitment for many governments.

### **2. How was OPEB accounting and financial reporting done prior to Statement 45?**

Prior to Statement 45, governments typically followed a “pay-as-you-go” accounting approach in which the cost of benefits is not reported until after employees retire. However, this approach is not comprehensive—only revealing a limited amount of data and failing to account for costs and obligations incurred as governments receive employee services each year for which they have promised future benefit payments in exchange.

### **3. What does Statement 45 accomplish?**

- When they implement Statement 45, many governments will report, for the first time, annual OPEB cost and their unfunded actuarial accrued liabilities for past service costs. This will foster improved accountability and a better foundation for informed policy decisions about, for example, the level and types of benefits provided and potential methods of financing those benefits.

The Standard also:

- Results in reporting the estimated cost of the benefits as expense each year *during the years that employees are providing services* to the government and its constituents in exchange for those benefits.
- Provides, to the diverse users of a government’s financial reports, more accurate information about the *total cost of the services* that a government provides to its constituents.
- Clarifies whether the amount a government has paid or contributed for OPEB during the report year has covered its annual OPEB cost. Generally, the more of its annual OPEB cost that a government chooses to defer, the higher will be (a) its unfunded actuarial accrued liability and (b) the cash flow demands on the government and its tax or rate payers in future years.
- Provides better information to report users about a government’s *unfunded actuarial accrued liabilities* (the difference between a government’s total obligation for OPEB and any assets it has set aside for financing the benefits) and changes in the *funded status of the benefits* over time.

#### 4. What are the most common misconceptions about Statement 45?

- a. **That it requires governments to fund OPEB.** Statement 45 establishes standards for *accounting and financial reporting*. How a government actually finances benefits is a policy decision made by government officials. The objective of Statement 45 is to more accurately reflect the financial effects of OPEB transactions, including the amounts paid or contributed by the government, whatever those amounts may be.
- b. **That it requires immediate reporting of a financial-statement liability for the entire unfunded actuarial accrued liability.** Statement 45 does not require immediate recognition of the unfunded actuarial accrued liability (UAAL) as a financial-statement liability. The requirements regarding the reporting of an OPEB liability on the face of the financial statements work as follows:
- Governments may apply Statement 45 prospectively. At the beginning of the year of implementation, nearly all governments will start with zero financial-statement liability.
  - From that point forward, a government will accumulate a liability called the *net OPEB obligation*, if and to the extent its actual OPEB contributions are less than its annual OPEB cost, or expense.
  - The net OPEB obligation (not the same as the UAAL) will increase rapidly over time if, for example, a government's OPEB financing policy is pay-as-you-go, and the amounts paid for current premiums are much less than the annual OPEB cost.

Statement 45 does, however, also require the *disclosure* of information about the *funded status* of the plan, including the UAAL, in the notes to the financial statements—and the presentation of multi-year funding progress trend information as a required supplementary schedule.

- c. **That it requires governments to report “future costs” for OPEB.** It is misleading and incorrect to describe accrual accounting for OPEB as requiring the expensing of “future costs.” From an accrual accounting standpoint (the basis of accounting required for all transactions in the government-wide financial statements), the reported expenses relate entirely to transactions (exchanges of employee services for the promised future benefits) that *already have occurred*. Statement 45 requires governments to report costs and obligations incurred as a consequence of receiving employee services, for which benefits are owed in exchange. The *normal cost* component of annual expense is the portion of the present value of estimated total benefits that is attributed to services received in the current year. The annual expense also includes an amortization component representing a portion of the UAAL, which relates to past service costs. Estimated benefit costs associated with *projected future years of service* are *not reported*.